

***United States Court of Appeals
for the
District of Columbia Circuit***



**TRANSCRIPT OF
RECORD**

BRIEF FOR APPELLANT AND JOINT APPENDIX

IN THE
United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

402

No. 21811

AMERICAN SECURITY AND TRUST COMPANY, TRUSTEE U/W OF
MALCOLM G. GIBBS f/b/o ANGELA GLORIA GIBBS, *Appellant*

v.

DISTRICT OF COLUMBIA, *Appellee*

No. 21812

AMERICAN SECURITY AND TRUST COMPANY, TRUSTEE U/W OF
MALCOLM G. GIBBS f/b/o HENRY FOOTE GIBBS, JR., *Appellant*

v.

DISTRICT OF COLUMBIA, *Appellee*

Appeal From the District of Columbia Tax Court

United States Court of Appeals
for the District of Columbia Circuit

FILED MAY 20 1968

JOHN E. LARSON
BENTON C. TOLLEY, JR.
910 American Security Bldg.
Washington, D. C.
Attorneys for Appellant

Nathan J. Paulson
CLERK

THE QUESTION PRESENTED

Did the District of Columbia Tax Court err by holding that appellant is liable to a tax on the earnings, profits or surplus, other than paid-in surplus, distributed to it during the taxable year of 1958, by the liquidating corporation, which said surplus was earned and accumulated by the liquidating corporation prior to January 1, 1939?

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DISTRICT OF COLUMBIA, *Appellee*

No. 21812

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v.

DISTRICT OF COLUMBIA, *Appellee*

Appeal From the District of Columbia Tax Court

BRIEF FOR APPELLANT

I

JURISDICTIONAL STATEMENT

This is an appeal from a decision of the District of Columbia Tax Court dated February 7, 1968, concluding that appellant was liable for an income tax on earnings, profits and surplus earned and accumulated by a corporation prior to the effective date of the first income tax law of the Dis-

trict of Columbia. (App. 4) A petition for review was filed March 1, 1968. (App. 1) Jurisdiction of this Court is invoked under the Title 47, Section 2404 of the District of Columbia Code, 1967, edition.

II

STATEMENT OF THE CASE

Appellant in both cases here consolidated is trustee of trusts created under the will of Malcolm G. Gibbs, deceased; one for the benefit of Angela Gloria Gibbs (Case No. 21811) and the other for the benefit of Henry Foote Gibbs, Jr. (Case No. 21812). The facts, tax deficiency amounts of corpus, and income of both trusts are identical. For this reason the two cases have been consolidated and in this brief will be referred to by appellant as one case.

The trusts owned capital stock of Stockwood Investment Company, a corporation, which had a substantial earned surplus, most of which had been earned by the corporation prior to January 1, 1939 (effective date of first income tax statute for the District of Columbia). A plan of complete liquidation was adopted and completed by the Stockwood Company. All its assets were distributed to its stockholders by way of three separate distributions in the taxable years of 1958, 1959 and 1960.

The total amount distributed to each trust in 1958 in the instant matter was \$757,939.05, which consisted of earnings, profits and surplus earned and accumulated by the Stockwood Company. Of that amount \$520,403.29 represented earnings, profits and surplus of the Company earned and accumulated prior to January 1, 1939. The balance (\$237,535.76) was earned and accumulated by the Company after January 1, 1939.

In reporting its income to the District of Columbia taxing authorities, appellant, as trustee of each trust, did not include the amount of \$520,403.29 in its tax return, taking the position that such amount represented earnings, profits

and surplus earned and accumulated by the Company prior to January 1, 1939, the effective date of the first income tax law of the District of Columbia, and that such amount was not taxable. The District of Columbia taxing authorities determined that the entire amount received as a liquidating distribution (\$757,939.05) was taxable and assessed a deficiency in income tax for the year of 1958. After hearing, the District of Columbia Tax Court, the Honorable Jo V. Morgan sitting, found that the entire amount of the distribution (\$757,939.05) was taxable. A formal decision in favor of appellee was entered on February 7, 1968.¹ The instant appeal followed.

III

STATEMENT OF POINTS

I. The court erred in determining that surplus earned and accumulated by a corporation prior to the enactment of any tax law in the District of Columbia was taxable when distributed by the corporation to its stockholders in the taxable year of 1958.

II. The court erred by retroactively applying a 1947 tax statute to a liquidating distribution of corporate surplus which said surplus had been earned prior to January 1, 1939.

IV

SUMMARY OF ARGUMENT

1. Had Congress intended the District of Columbia Income and Franchise Tax Act of 1947 to operate retroactively, it would have expressly made provision for its retroactive application.

2. The Tax Court's determination that any liquidating distribution made by a corporation to its stockholders from

¹ Other issues were involved in this matter and were resolved by the District of Columbia Tax Court. Such issues, however, are not involved in this appeal.

corporate earnings, profits or surplus, regardless of when it was earned by the corporation, is taxable as a dividend to the stockholder in the year it was received is offensive to due process guaranteed by the Fifth Amendment of the Constitution.

3. The precedents set by the courts in dealing with some of the problems created when the Federal Income Tax Act became effective on March 1, 1913, should be controlling in the case at bar.

V

ARGUMENT

1. The District of Columbia Income and Franchise Tax Act of 1947 Is Not Applicable in This Case Congress Not Having Made Such Act Retroactive

The first income tax law adopted in the District of Columbia was known as the District of Columbia Income Tax Act enacted by Congress on July 26, 1939. (53 Stat. 1087, Chapter 367, Title II, Section 1). It became effective on January 1, 1939. The portion applicable to the instant matter provides as follows:

"The word 'dividend' means any distribution made by a corporation out of its earnings or profits to its stockholders or members whether such distribution be made in cash, or any other property, other than stock of the same class in the corporation. It includes such portion of the assets of a corporation distributed at the time of dissolution as are in effect a distribution of earnings."

(Par. 16 of section 47-1543 of the D. C. Code, 1940 edition.)

The applicability of this provision to distributions made by a corporation from its earnings, profits and surplus, earned and accumulated prior to January 1, 1939 was determined by the District of Columbia Tax Court on as many as three occasions. The first was the case of *Cooper v.*

District of Columbia, D.C.B.T.A., Opinion No. 617. *Himmelfarb v. District of Columbia*, D.C.B.T.A., Opinion No. 628 was the second case, and *Harrison v. District of Columbia*, D.C.B.T.A., Opinion No. 644 was the third. In each of these cases, the District of Columbia took the position that on liquidation of a corporation, the stockholders were liable for income tax on so much of the distribution made as represented earnings, profits and surplus of the corporation, regardless of when it was earned. In each of the above cases the District of Columbia Tax Court (then known as the Board of Tax Appeals) held that distributions made from earnings, profits and surplus of a corporation accumulated prior to January 1, 1939, the effective date of the income tax law in the District of Columbia, would not be taxed by the District of Columbia. A portion of the Tax Court's decision in the *Harrison* case, *supra*, is as follows:

"The District contends that on liquidation of a corporation the stockholders become liable for income tax upon so much of the distribution of the corporation's assets as represents earned surplus, regardless of when the surplus was earned. D. C. Code 1943, secs. 47-1504, 47-1543 (16)."

"The Board holds that so much of the earned surplus as represents earnings or profits prior to January 1, 1939, the effective date of the income tax law, may be distributed to the stockholders free of income tax to them; and that so much of the earned surplus as represents earnings or profits of the corporation on or after January 1, 1939, is taxable."

Thus it may be seen and as the Court below so held (pages 4 and 5 of its Opinion, App. 8, 9) that where a corporation was dissolved and its assets distributed to its stockholders, the stockholders did not receive a taxable dividend under the District of Columbia Income Tax Act of 1939 as to so much of the distribution as represents earnings, profits or surplus of the corporation earned prior to January 1, 1939.

On July 16, 1947, some eight years after the District of Columbia Income Tax Act of 1939 was adopted, Congress enacted the District of Columbia Income and Franchise Act of 1947. Section 4 (m) of Title I of that Act (Section 47-1551 c (m) D. C. Code, 1961 edition) is pertinent to this discussion and provides as follows:

“The word ‘dividend’ means any distribution made by a corporation (domestic or foreign) to its stockholders or members, out of its earnings, profits or surplus (other than paid-in surplus), whenever earned by the corporation and whether made in cash or any other property * * * and whether distributed prior to, during, upon, or after liquidation or dissolution of the corporation: * * *.”

What effect, if any, did this change in the tax law of the District of Columbia have upon this case? Judge Morgan in his opinion below concluded that such change in the law was controlling. He held:

“The Court believes that the insertion of the phrase ‘whenever earned by the corporation’ in the 1947 definition of ‘dividend’ by Congress was to correct that interpretation of the 1939 definition by Judge Koenigsberger in the *Cooper*, *Himmelfarb* and *Harrison* cases, or, at least to clarify the definition, so there could be no mistake or misunderstanding as to what Congress intended. The phrase ‘whenever earned by the corporation’ is not only significant, but is controlling. For that reason the Court concludes that the petitioner in both cases is liable to an income tax on earnings, profits or surplus, earned and accumulated prior to January 1, 1939, and distributed [to] it as trustee for the Angela Gloria Gibbs and Henry Foote Gibbs, Jr. trusts.

(Page 7, Findings of Fact and Opinion App. 11.)

Appellant contends that the holding of the District of Columbia Tax Court was erroneous in this regard. Had Congress intended to retroactively reach back some eight years or more and tax distributions in liquidation of pre 1939 corporate earnings, profits and surplus under the Dis-

trict of Columbia tax laws, it would have done so in clear, imperative language commanding it. An exhaustive search of the legislative history pertaining to the District of Columbia Income and Franchise Act of 1947, including all printed and unprinted documents from 1939 to date reveals not one word about the Act being retroactive in application. It is interesting to note from the study of the legislative history that with the exception of the addition of the words "whenever earned" in the 1947 Act, there was not one change made in the 1939 Act by the 1947 Act which was not thoroughly discussed on the floor of Congress, or in the extensive hearings on the 1947 Act. Had the words "whenever earned" been included in the 1947 Act by Congress to avoid, nullify or clarify the effect of the *Cooper*, *Himmelfarb* and *Harrison* cases as the District Tax Court speculates, the legislative history of the 1947 Act would clearly reflect such facts.

Furthermore, it is well established law that courts are loathe to render retroactive application to a statute and will avoid such construction unless the statute by its terms expressly provides for retroactivity. A clear expression of this principle is enunciated in *Neild v. District of Columbia*, 306 App. D. C. 306, 110 F. 2d 246, 254, in the following terms:

"The rule is well settled that unless the contrary plainly appears a statute operates prospectively only; in other words, that a statute ought not to be construed to operate retrospectively in the absence of clear, strong and imperative language commanding it; and if a double sense is possible that which rejects retroactive operation must be selected."

Since Congress did not expressly make the 1947 Act retroactive in application, appellant submits that such Act has no application to the taxability of the surplus earned and accumulated by the Stockwood Investment Company prior to January 1, 1939. It is difficult for appellant to believe that Congress enacted legislation in 1947 imposing a tax on surplus accumulated prior to 1939, which never

before had been taxable in the District of Columbia, without having some discussion or making some mention of it in its preliminary considerations of such legislation. Appellant would speculate that some District of Columbia tax official, irritated over the decisions in the *Cooper*, *Himmelfarb* and *Harrison* cases, inserted the words "whenever earned" in the proposed 1947 Act and it was enacted into law without Congress knowing or having its attention called to full effect and meaning of such a change in the law.

2. The Assessment of Additional Tax Based Upon the Contention That the District of Columbia Income and Franchise Act of 1947 Imposes a Tax on Pre 1939 Surplus Distributed in 1958 Is Arbitrary and Capricious and Constitutes a Violation of the Fifth Amendment to the Constitution

The District of Columbia Tax Court has determined that under the District of Columbia Income and Franchise Tax Act of 1947, as amended, any liquidating distribution made by a corporation to its stockholders from the corporation's earnings, profits or surplus, regardless of when it was earned or accumulated by the corporation, is taxable as a dividend in the year it was received by the stockholder. Such a determination by the Tax Court is in violation of due process as required by the Fifth Amendment of the Constitution of the United States and is therefore invalid. Appellant is the first to call the Court's attention to decisions of the Supreme Court and other courts holding generally that retroactive application of a tax statute raises no violation of rights guaranteed by the Constitution. However, the attention of the Court is invited to the facts, circumstances and language of these cases. What the courts have stressed in each instance in which they have upheld the statute has been the reasonableness of the retroactive period as such, and the reasonable expectations of the taxpayers. In speaking of the reasonableness of the statute, the courts have always pointed to the short period

of time back during which the statute was made to apply. The period has varied from a few months to a few years.

The case of *Welch v. Henry*, 305 U.S. 134 is a clear and leading expression of the status of the law on this point. In that case the tax law in question reached back two years, and the Supreme Court said it did not find the retroactive period unreasonable:

"In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation." (p. 147)

The language is definite and the implication is inescapable that the Court felt that a constitutional limitation could and would be asserted, if the period of time over which the statute reached was unreasonable, thereby rendering the provision arbitrary and capricious and a violation of due process.

The *Welch v. Henry* case has been applied by the Court of Appeals of New York. In 1935 the New York legislature passed an expressly retroactive taxing statute, whereby income produced on property out of the State was taxable back to 1913, the date of original income taxation legislation in the State. The 1935 statute was struck down as "unreasonable, arbitrary, capricious and palpably unjust." The Court cited *Welch v. Henry*, *supra*, and indicated that it would be absurd to compare retroactivity in terms of two years with retroactivity in terms of sixteen years. The 1935 statute was held invalid as a violation of due process. *People ex rel. Beck v. Graves*, 280 N.Y. 405, 21 N.E. 2d 371. See also *Lacidem Realty Corp. v. Graves*, 288 N.Y. 354, 43 N.E. 2d 440, where a reaching back of four years only was sufficient to move the Court.

With regard to due process, the Tax Court in its opinion relied heavily on the case of *Fallett v. Commissioner*, 267

Mass. 115, 166 N.E. 575, and the cases cited therein as to whether the tax law as interpreted was unconstitutional. Examination of said cases does not seem to foreclose a constitutional argument as was suggested. In *Tax Commissioner v. Putnam*, 227 Mass. 522, 116 N.E. 904, 909, the court stated with regard to gains on sale of intangible property that, "Therefore no question either of statute interpretation or constitutionality is raised in the cases at bar . . . , and nothing to that point is here decided." With regard to a stock dividend or a cash dividend, which is closer to the issue involved herein, the emphasis of the court was on the source of such dividends and whether they were to be treated as income or capital rather than the constitutional problems. In *Lanning v. Tax Commissioner*, 247 Mass. 496, 142 N.E. 829, the court considered only whether a stock dividend was taxable and the retroactive period was relatively short compared to the facts present in the case at bar. The cases of *Done v. Jackson*, 256 U.S. 589, 41 S. Ct. 566, which considered the constitutionality of a plan to redistribute income tax among subdivisions and *Stebbins v. Riley*, 286 U.S. 157, 45 S. Ct. 424, which considered the question of whether federal estate tax may be deducted in determining the inheritance tax due to a state do not seem to be applicable at all.

One of the most comprehensive and recent analyses of prior cases dealing with this point of law is found in the case of *Comptroller of Treasury v. Glenn L. Martin Co.*, 216 Md. 235, 140 A. 2d 288. In this case the Maryland Court of Appeals concluded that: "It is well established that a tax is not necessarily invalid simply because it is retroactive." However, the Court recognized that some retroactive applications were unconstitutional, and after a thorough and well reasoned opinion, concluded that a period of ten years was so unreasonable as to render the retroactivity required by the change in the law invalid by constitutional bar.

It is evident from these cases that the constitutionality of a taxing statute which carries a retroactive effect is

determined by the length of the period over which the tax liability reaches and asserts itself. If the period is short, the retroactive feature of the tax law may be reasonable and constitutional in application. If the period is unduly long, the legislation is deemed arbitrary and capricious and in violation of the Constitution. Not only does appellee ask this Court to retroactively apply the 1947 Act for eight years or more, but it asks this Court to go back and tax the earnings, profits and surplus of the corporation which were earned and accumulated before the enactment of any tax legislation in the District of Columbia. Certainly such an application of the law would be arbitrary, capricious, unreasonable and invalid under any constitutional standards.

3. Had the Surplus Involved in This Case Been Accumulated Prior to March 1, 1913, the Effective Date of the Federal Tax Statute, It Would Not Have Been Taxable Under That Statute

It should be helpful to the Court to examine the decisions of the Supreme Court of the United States dealing with some of the problems when the Federal Income Tax Act became effective on March 1, 1913. Three separate opinions were handed down by the Supreme Court on June 3, 1918 and all three are appropriate for consideration in the instant case. The first was the case of *Lynch v. Turrish*, 247 U.S. 221, a case quite similar to the case at bar. In this case, due to a gradual increase in the market value of timber lands owned by a corporation, the market value of its shares of stock had increased to twice the par value of the stock by March 1, 1913, when the Income Tax Act of that year took effect. After March 1, 1913, the company sold all its property, went through a process of complete liquidation and made a final distribution of the proceeds of the sales to its stockholders on surrender of their stock certificates, the amount received by each stockholder being twice the par value of his shares. The Collector of Internal Revenue attempted to tax the amount received by the shareholder in excess of his par value. The Court held that the value thus received by the shareholder in excess of the par

value of his stock was not "income, gains or profits" subject to tax because it represented merely a conversion of his existing investment and did not arise or accrue after the Tax Act became effective. A portion of the Court's opinion pertinent is as follows:

"And in determining the application of the statute to Turrish we must keep in mind that on the admitted facts the distribution received by him from the Payette Company manifestly was a single and final dividend in liquidation of the entire assets and business of the company, a return to him of the value of his stock upon the surrender of his entire interest in the company, and at a price that represented its intrinsic value at and before March 1, 1913, when the act took effect." (p. 226)

The second case is *Southern Pacific Company v. Lowe*, 247 U.S. 330. In this case, accumulations had accrued to a corporation through surplus earnings and by appreciation in the value of properties owned by the corporation before the adoption of the Sixteenth Amendment, and the effective date of the Income Tax Act of 1913. The Court held that where the shares of the corporation were all owned, and its property and funds possessed, and its operations and affairs completely dominated, by another corporation, so that in substance the two corporations were but one corporation and the distribution made represented merely what the second company was entitled to have as a shareholder before January 1, 1913, from a surplus theretofore accumulated, such distributions were not taxable under the Income Tax Act of 1913. One portion of the Court's opinion particularly applicable to the instant case is:

"* * * we are bound to consider accumulations that accrued to a corporation prior to January 1, 1913, as being capital, not income, for the purposes of the act. And we perceive no adequate ground for a distinction, in this regard, between accumulation of surplus earnings, and the increment due to appreciation in value of the assets of the taxpayer." (p. 335)

The third case is *Lynch v. Hornby*, 247 U.S. 330. In this case one Hornby was the owner of 434 shares of the 10,000 issued and outstanding shares of stock of the Cloquet Lumber Company. In 1914, shortly after the effective date of the Federal Income Tax Act, the Company distributed a dividend to each of its stockholders from current earnings and from the conversion into cash of property the Company had owned on March 1, 1913. Hornby reported the portion of his dividend paid from current earnings of the Company on his 1914 income tax return, but he did not report that portion which was paid from the sale of properties the Company had owned on March 1, 1913. The Collector of Internal Revenue levied an additional tax against Hornby and he filed suit. The Court held that under the Federal Income Tax Act of 1913, all dividends paid or declared in the ordinary course of business by a corporation to a stockholder after March 1, 1913, whether from current earnings, or from accumulated surplus, notwithstanding it had been accumulated prior to March 1, 1913, were taxable. The Court was careful to point out, however, that its decision was applicable only to dividends paid by a corporation "in the ordinary course of business" and it was not applicable where a corporation was winding up its affairs or was in the process of liquidation. At page 341 of its opinion, the Court stated:

"The case was tried in the District Court and argued in the Circuit Court of Appeals together with *Lynch v. Turrish*, (236 Fed. Rep. 653), and was treated as presenting substantially the same question on the merits. In our opinion it is distinguishable from the *Turrish Case*, where the distribution in question was a single and final dividend received by Turrish from the Payette Company in liquidation of the entire assets and business of the company and a return to him of the value of his stock upon the surrender of his entire interest in the company, at a price that represented its intrinsic value at and before March 1, 1913, when the Income Tax Act took effect."

Thus it would seem that under the Federal Income Tax Act of 1913, as construed by the Supreme Court, if a corporation distributed its surplus, earned or accumulated, prior to the effective date of the tax statute, in liquidation of the corporation, such distribution was not taxable to the stockholders. If, on the other hand, the corporation distributed its surplus, earned or accumulated prior to the effective date of the tax statute, in the ordinary course of its business affairs and continued to operate as a corporation, such distribution to its shareholders would be taxable. The same should be true in the case at bar. Here the Stockwood Investment Company, Inc. had been in operation for many years. When the District of Columbia Income Tax Act of 1939 was enacted, Stockwood already had a large accumulation of surplus which it had earned and accumulated. Certainly upon liquidation of Stockwood, that portion of the distribution which consisted of the accumulated surplus accrued prior to January 1, 1939, should pass to the stockholders free and clear of any tax. This was the basis of Judge Koenigsberger's decision in the *Harrison v. District of Columbia*, *supra*, as evidenced by his memorandum of law which accompanied his decision.

VI

CONCLUSION

For the reasons hereinabove set forth, Congress did not intend the District of Columbia Income and Franchise Tax Act of 1947 to reach back and tax the distribution of corporate surplus earned and accumulated prior to the enactment of any tax law in the District of Columbia. Therefore, the decision of the District of Columbia Tax Court holding otherwise should be set aside and vacated.

Respectfully submitted,

JOHN E. LARSON

BENTON C. TOLLEY, JR.

910 American Security Bldg.
Washington, D. C.

Attorneys for Appellant

JOINT APPENDIX

[Filed March 1, 1968]

DISTRICT OF COLUMBIA TAX COURT

Docket No. 1961

AMERICAN SECURITY AND TRUST COMPANY, Surviving Trustee
u/w of MALCOLM G. GIBBS f/b/o HENRY FOOTE GIBBS, JR.,
Petitioner,

v.

DISTRICT OF COLUMBIA, *Respondent.*

**Petition for Review of Decision of the District of Columbia
Tax Court**

To the Honorable Chief Judge and Circuit Judges of the
United States Court of Appeals for the District of Columbia
Circuit:

1. American Security and Trust Company, Trustee under the will of Malcolm G. Gibbs, deceased, for the benefit of Henry Foote Gibbs, Jr., petitioner herein, petitions for a review by the United States Court of Appeals for the District of Columbia Circuit, of a decision of the District of Columbia Tax Court made in the above-entitled case.

2. The decision of which review is sought partially affirmed assessments of fiduciary income taxes for the year of 1958.

3. The decision of the Tax Court was entered on February 7, 1968.

LARSON AND TOLLEY

By: BENTON C. TOLLEY, JR.

Attorneys for Petitioner

910 American Security Bldg.
Washington, D. C. 20005

DISTRICT OF COLUMBIA TAX COURT

Docket No. 1960

AMERICAN SECURITY AND TRUST COMPANY, Surviving Trustee
 u/w of MALCOLM G. GIBBS, for the benefit of ANGELA
 GLORIA GIBBS, *Petitioner*,

v.

DISTRICT OF COLUMBIA, *Respondent*.

Counsel: Benton C. Tolley, Jr., Esq.
 Larson and Tolley

Address: 910 American Security Building,
 Washington, D. C. 20005

Docket

Date	Proceedings	Memorandum
1964		
Dec. 8—	Petition filed—Certificate of service.	
		Income Tax \$56,692.20
1965		
Jan. 26—	Hearing set for Feb. 9—Certificate of service.	
Feb. 3—	Motion for an extension of time filed by petitioner	
	—Granted—Hearing set for April 27. Certificate of service.	
May 7—	Motion for extension of time—Granted—Certificate of service.	
May 24—	Motion to place case on Reserve Calendar—	
	Granted—Certificate of service.	
1966		
Nov. 9—	Hearing set for Dec. 12—Certificate of service.	
Dec. 9—	Hearing cancelled to a later date.	

1967

Mar. 1—Hearing set for Mar. 13—Certificate of service.

Mar. 9—Motion for extension of time—Granted to May 10—
Certificate of service.

May 9—Motion for extension of time.

May 10—Motion granted—hearing continued to June 15—
Certificate of service.

June 5—Joint motion for Pre-trial of case—Granted—
Certificate of service.

June 16—Pre-trial—Henry E. Wixon, Esq., for District.

July 31—Motion for extension of time to file memorandum.

Aug. 4—Motion granted—Certificate of service.

Aug. 21—Motion for extension of time to file memorandum
—Motion granted—Certificate of service.

Aug. 28—Stipulation.

Sept. 8—Petitioner's brief—Certificate of service.

Oct. 26—Findings of Fact—Opinion—Certificate of service.

1968

Feb. 6—Stipulation for entry of Decision.

Feb. 7—Decision—Certificate of service.

Mar. 1—Petition for review and Designation of Record—
Certificate of service.

[Filed February 7, 1968]

Decision

The parties hereto having filed a stipulation for computation under Rule 30, and the Court having considered such computation and the evidence taken at the hearing of this appeal and the findings heretofore made herein, it is by the Court this 7th day of February, 1968

ADJUDGED AND DETERMINED, That a deficiency in fiduciary income taxes assessed against petitioner for the year 1958 shall be increased in the amount of \$953.14, with interest thereon at the rate provided by law from April 15, 1959 to the date of payment thereof;

FURTHER ADJUDGED AND DETERMINED, That petitioner is entitled to a refund, in part of fiduciary income taxes assessed as a deficiency against it for the year 1959, which said refund amounts of \$261.34, with interest thereon at the rate provided by law from September 15, 1964 to the date of the payment of said refund; and

FURTHER ADJUDGED AND DETERMINED, That a deficiency in fiduciary income taxes assessed against petitioner for the year 1960 shall be increased in the amount of \$1,550.60, with interest thereon at the rate provided by law from April 15, 1961 to date of payment thereof.

Jo. V. MORGAN
Jo. V. Morgan,
Judge

Served as follows:

[Filed October 26, 1967]

DISTRICT OF COLUMBIA TAX COURT

Docket No. 1960

AMERICAN SECURITY AND TRUST COMPANY Surviving Trustee
under will of MALCOLM G. GIBBS, for the benefit of
ANGELA GLORIA GIBBS, *Petitioner*,

v.

DISTRICT OF COLUMBIA, *Respondent*.

Docket No. 1961

AMERICAN SECURITY AND TRUST COMPANY Surviving Trustee
under will of MALCOLM G. GIBBS, for the benefit of
HENRY FOOTE GIBBS, JR., *Petitioner*,

v.

DISTRICT OF COLUMBIA, *Respondent*.

Findings of Fact and Opinion

The petitioner in the above two cases complains of income taxes against it as trustee in the above trusts for the calendar years 1958, 1959 and 1960, upon assets, including stock and stock rights. The respondent contends that the assessments were valid. The issues involved in the two cases are identical. The cases have been consolidated for disposition.

FINDINGS OF FACT

The parties have stipulated the facts to be considered by the Court, and, as stipulated those facts are found by the Court.

OPINION

Originally in these cases several issues were involved. Some have been abandoned. In respect of the remaining issues the parties have stipulated as follows:

"6. The only issues remaining to be resolved under the District of Columbia Income and Franchise Tax Act of 1947, as amended, are:

"A. Whether petitioner is liable to a tax on the earnings, profits or surplus, other than paid-in surplus, distributed to it during the taxable year of 1958, by the liquidating corporation, which said surplus was earned and accumulated by the liquidating corporation prior to January 1, 1939?

"B. Whether petitioner may assign a proportional share of its cost of certain stocks it held to subscription rights issued on said stocks, which said subscription rights were sold by the petitioner during the years of 1958 and 1959?

"C. Whether petitioner may assign a proportional share of its cost of certain stocks it held to fractional shares of stock received as a stock dividend on said stocks, which said fractional shares were sold by petitioner during the taxable years of 1958 and 1959?"

The Court will attempt to resolve the three issues.

DISTRIBUTION OF SURPLUS EARNED OR ACQUIRED PRIOR TO JANUARY 1, 1939

The first income tax law of the District of Columbia¹ was effective January 1, 1939. Section 2 of that act levied a tax upon the taxable income of individuals; Section 3

¹ Title II—INCOME TAX (called "District of Columbia Income Tax Act") of District of Columbia Revenue Act of 1939, approved July 26, 1939, and entitled "An Act to provide revenue for the District of Columbia, and for other purposes."

defined taxable income as gross income less deductions; and Section 4 provided that "The words 'gross income', as used in this title, include * * * dividends * * *." "Dividend" in Section 43(16) was defined as follows:

"The word 'dividend' means any distribution made by a corporation out of its earnings or profits to its stockholders or members whether such distribution be made in cash, or any other property, other than stock of the same class in the corporation. It includes such portion of the assets of a corporation distributed at the time of dissolution as are in effect a distribution of earnings."

By Section 1 of Title I of Article I—INCOME AND FRANCHISE TAX ACT of the District of Columbia Income and Franchise Tax Act of 1947, approved July 16, 1947, (Section 47-1551, D. C. Code, 1961 Edition) Congress repealed the 1939 income tax law, and levied an individual income tax on dividends effective January 1, 1947. Section 4(m) of the District of Columbia Income Tax Act (1947), Section 47-1551c(m) of the Code altered or changed the definition of "dividend". It provided that:

"The word 'dividend' means any distribution made by a corporation (domestic or foreign) to its stockholders or members, out of its earnings, profits, or surplus (other than paid-in surplus), *whenever earned by the corporation* and whether made in cash or any other property * * * and whether distributed prior to, during, upon, or after liquidation or dissolution of the corporation: * * *" (*Emphasis supplied.*)

It will be noted that Congress included in the 1947 law the provision that the distributed "earnings, profits or surplus" should constitute a dividend regardless of when they were earned. No such provision was in the 1939 law.

The petitioner in both of the two cases here consolidated is the trustee of two trusts created by the will of Malcolm

G. Gibbs, deceased,—one for the benefit of Angela Gloria Gibbs (Docket No. 1960) and the other for the benefit of Henry Foote Gibbs, Jr. (Docket No. 1961). The amounts of corpus and income of both trusts are the same.

The trusts owned substantial amounts of the capital stock of Stockwood Investment Company, a corporation, which had a substantial earned surplus, a large part of which was earned prior to January 1, 1939. A plan of complete liquidation was adopted and completed by the corporation, and all of its assets were distributed to its stockholders in three distributions, that is to say, a distribution in each of the years 1958, 1959 and 1960.

The total amount distributed to each trust here involved in 1958 was \$757,939.05, which consisted of earnings, profits and surplus (other than paid-in surplus). Of that amount \$520,403.29 represented earnings, profits and surplus (other than paid-in surplus) earned prior to January 1, 1939.

In reporting its income to the assessing authority of the District for tax purposes the petitioner as trustee for each trust did not include the amount of \$520,403.29, representing earnings, profits and surplus earned by Stockwood Investment Company prior to 1939. The assessing authority of the District determined that the entire amount received as a liquidating distribution (\$757,939.05) was a taxable dividend, and accordingly assessed the petitioner as trustee in each trust a deficiency in income tax. It is from that assessment that the petitioner, as trustee in each trust, here appeals.

The petitioner cites three decisions of the Board of Tax Appeals of the District of Columbia,² namely, *Cooper v. District of Columbia*, D.C.B.T.A., Opinion No. 617; *Himmelfarb v. District of Columbia*, D.C.B.T.A., Opinion No. 628; and *Harrison v. District of Columbia*, D.C.B.T.A., Opinion No. 644. In those cases Judge Koenigsberger ruled that

² Now the District of Columbia Tax Court.

where a corporation was dissolved and its assets were distributed to its stockholders the stockholders did not receive taxable dividends *under the then existing law* as to so much of the distribution to them of the corporation's assets resulting from earnings, profits or surplus (other than paid-in surplus) earned prior to January 1, 1939. It is important to note that the *Cooper* case was decided November 13, 1946, *Himmelfarb* case February 6, 1947, and *Harrison* case on June 12, 1947,—all before the enactment of the District of Columbia Income and Franchise Tax Act of 1947 on July 16, 1947. Congress corrected the effect of the decisions in those cases by inserting in the 1947 definition of "dividend" the phrase "*whenever earned by the corporation*", which, as observed above, was not in the 1939 definition. For the reasons stated, the Court does not believe that those three cases are helpful or should be considered precedents to be followed.

The other cases cited by the petitioner do not seem to be pertinent. The statutes to which they relate are substantially different from the 1947 District of Columbia law. The Court has been unable to find any Federal Statutory provision or any state law that contains language exactly or substantially like the clear and positive phrase "*whenever earned by the corporation*", found in the 1947 definition of "dividend".

The petitioner's contention that the assessment, of which it here complains, was violative of the Fifth Amendment of the Constitution is without merit. The petitioner concedes, and the United States Supreme Court has held that there is nothing unconstitutional in the income tax assessment of a dividend which was in effect a distribution of surplus earned prior to March 1, 1913, if the distributing corporation is *engaged in the ordinary course of business*. See: *Lynch v. Hornby*, 247 U.S. 339, 62 L.Ed. 1149, 38 S. Ct. 543; *Welch v. Henry*, 305 U.S. 134, 143, 83 L.Ed. 87, 59 S. Ct. 12; *Helvering v. Canfield*, 291 U.S. 163, 78 L.Ed. 706, 54 S. Ct. 368; *United States v. Safety Car Heating & Lighting Co.*,

297 U.S. 88, 80 L.Ed. 391, 56 S. Ct. 91. Several state courts have so held: *Kelly v. Galloway*, 156 Ore. 301, 66 P. 2d 272; *Trefry v. Putnam*, 227 Mass. 522, 116 N.E. 904; *Lapham v. Tax Commissioner*, 244 Mass. 40, 138 N.E. 708; *Martin v. State Board*, 225 Iowa 1319, 283 N.W. 418; *West v. Wisconsin Tax Com.*, 207 Wis. 557, 242 N.W. 165; *Van Dyke v. City of Milwaukee*, 159 Wis. 460, 146 N.W. 812.

If the taxing of dividends from earnings prior to the effective date of the levying statute is constitutional where the distributing corporation is still engaged in business, the taxing of a dividend from earnings prior to the effective of the levying statute in accordance with the plain and positive provisions of the statute upon dissolution of the corporation is likewise constitutional, especially since the dissolution with resulting distribution is not a capital transaction.³

An important case is *Follett v. Commissioner*, 267 Mass. 115, 166 N.E. 575. Resort must be had to *Trefry v. Putnam*, *supra*, because, while in *Follett* reference is made to the year 1916, it is not therein shown that the statute under consideration was enacted in that year. It does appear so in *Trefry v. Putnam*. That statute, as far as pertinent here, is not unlike the District of Columbia law. A part of the income distributed to stockholders of a corporation upon its dissolution arose from the sale of land which had been acquired by the use of profits earned prior to 1916. All of the surplus, with the exception of the capital stock investment (\$100 a share), was declared to be taxable. In respect of the complaint that the interpretation of the Massachusetts income tax law as interpreted was unconstitutional, in that it operated to deprive persons of their property without due process of law, the Supreme Judicial Court said:

"* * *. These questions are foreclosed by *Tax Commissioner v. Putnam*, 227 Mass. 522, 116 N.E. 904,

³ *Berliner v. District of Columbia*, 103 U.S. App. D.C. 351, 258 F. 2d 651, 86 W.L.R. 456.

L.R.A. 1917 F, 806; *Lanning v. Tax Commissioner*, 247 Mass. 496, 142 N.E. 829; *Dane v. Jackson*, 256 U.S. 589, 41 S. Ct. 566, 65 L.Ed. 1107, and *Stebbins v. Riley*, 268 U.S. 137, 45 S. Ct. 424, 69 L.Ed. 884, 44 A.L.R. 1454, and do not require further discussion."

The Court believes that the insertion of the phrase "whenever earned by the corporation" in the 1947 definition of "dividend"⁴ by Congress was to correct the interpretation of the 1939 definition by Judge Koenigsberger in the *Cooper*, *Himmelfarb* and *Harrison* cases, or, at least, to clarify the definition, so that there could be no mistake or misunderstanding as to what Congress had intended. The phrase "whenever earned by the corporation" is not only significant, but is controlling. For that reason the Court concludes that the petitioner in both cases is liable to an income tax on earnings, profits or surplus, other than paid-in surplus, earned and accumulated prior to January 1, 1939, and distributed it as trustee for the Angela Gloria Gibbs and Henry Foote Gibbs, Jr. trusts.

Sale of Stock Subscription Rights and Fractional Shares of Stock

The petitioner, as trustee of the Angela Gloria Gibbs and Henry Foote Gibbs, Jr. trusts in 1958 and 1959 received stock subscription rights and fractional shares of stock as stock dividends from certain corporations in which the petitioner, as trustee, owned capital stock. The sole question to be solved herein, as stated hereinbefore, is whether, in the computation of the petitioner's income tax liability for the two years mentioned, proportional shares of the cost of the respective capital stock held by it can be assigned to the stock subscription rights and fractional shares received as stock dividends as a basis for the determination of gain from the sale of non-capital assets.⁵ The

⁴ Section 4(m), Title I, Article I, Income and Franchise Tax, D.C. Rev. Act of 1947, Section 47-1551c(m) D. C. Code, 1961 Edition.

⁵ See Section 47-1551c(1) and 47-1557(b)(11), D. C. Code, 1961 Edition.

Court is of the opinion that a proportional share of the cost of the respective capital stock owned by the petitioner, as trustee, can be assigned to the stock subscription rights and fractional shares.

There is no provision in the District of Columbia Income and Franchise Tax Act nor in regulations for its administration which authorized the above ruled assignment of cost. Nor is there, on the other hand, any authorization for the assessing authority to deny any basis for determining gain from the sale of the stock subscription rights and fractional shares of stock. The United States Court of Appeals has held, that in such a case Federal rules should be applied, unless to do so would violate some public policy or the like. Section 307 of the Internal Revenue Code of 1954, and Section 1.307-1 pertaining thereto provides for the assignment of cost asked by the petitioner. There seems no reason why the Federal provisions should not be followed. Moreover, in the opinion of the Court, the assignment of a proportional share of the cost of the respective stock to the stock subscription rights and fractional shares is logical and fair.

Decision will be entered under Rule 30.

JO. V. MORGAN

Jo. V. Morgan

Judge

Stipulation

The original petition in this case was filed in the District of Columbia Tax Court on December 8, 1964. When the case was filed, it contained several issues involved in other cases pending before the said Tax Court and the United States Court of Appeals, District of Columbia Circuit. This case has been on the reserve calendar of the Tax Court awaiting final disposition of such issues by the aforesaid Courts. The decisions of said Courts respecting such issues have resulted in a change in the original amount in

controversy in the case and made the present posture of the case such that if the Court resolves the issues in favor of petitioner, it would be entitled to a refund of approximately \$17,500. If, on the other hand, the Court should resolve the issues in favor of respondent, petitioner would owe respondent additional taxes in the approximate amount of \$2,300. Accordingly, petitioner and respondent, by their respective counsel, hereby stipulate and agree as follows:

1. Petitioner is a corporation organized and doing business under the laws of the District of Columbia with its offices and principal place of business at 15th Street and Pennsylvania Avenue, Northwest, Washington, D. C., where it is engaged in the trust and banking business. It filed its petition herein as surviving Trustee under item FIFTH of the Last Will and Testament of Malcolm G. Gibbs, deceased, for the benefit of Angela Gloria Gibbs.

2. Petitioner, as Trustee of the above mentioned trust, held 7,345 shares of the 17,500 issued and outstanding shares of stock of the Stockwood Investment Company, Inc., a Delaware corporation engaged in business in the District of Columbia. A plan of complete liquidation was adopted by the Stockwood Investment Company and all assets of said company were distributed to its stockholders by way of three distributions. Said three distributions involve the taxable years of 1958, 1959 and 1960.

3. The total liquidating distribution received by petitioner in 1958 (\$757,939.05), consisted of earnings, profits or surplus, other than paid-in surplus, earned and accumulated by the Stockwood Investment Company prior to January 1, 1939 (\$520,403.29) and earnings, profits or surplus, other than paid-in surplus, earned and accumulated by the Stockwood Investment Company subsequent to January 1, 1939 (\$237,535.76). Respondent taxed petitioner on the total of said distribution (\$757,939.05) as a dividend.

4. In 1958, petitioner, as Trustee, received some rights to subscribe to some additional shares of stock and some

fractional shares of stock on its holdings of Addressograph-Multigraph Company and Wisconsin Electric Company stock. Petitioner sold the stock rights and fractional shares of stock in 1958 and received the total sum of \$545.37 from such sales. Petitioner's cost of said stock rights and fractional shares, based upon the allocation of a proportion of its cost of the Addressograph-Multigraph Company and Wisconsin Electric Company stock, was \$190.10. Respondent taxed petitioner on the entire proceeds (\$545.37) it received from said sales.

5. In 1959, petitioner, as Trustee, received some rights to subscribe to some additional shares of stock and some fractional shares of stock on its holdings of Addressograph-Multigraph Company and Washington Gas Light Company stock. Petitioner sold the stock rights and fractional shares of stock in 1959 and received the total sum of \$151.62 from such sales. Petitioner's cost of said stock rights and fractional shares, based upon the allocation of a proportion of its cost of the Addressograph-Multigraph Company and Washington Gas Light Company stock, was \$55.84. Respondent taxed petitioner on the entire proceeds (\$151.62) it received from said sales.

6. The only issues remaining to be resolved under the District of Columbia Income and Franchise Tax Act of 1947, as amended, are:

A. Whether petitioner is liable to a tax on the earnings, profits or surplus, other than paid-in surplus, distributed to it during the taxable year of 1958, by the liquidating corporation, which said surplus was earned and accumulated by the liquidating corporation prior to January 1, 1939?

B. Whether petitioner may assign a proportional share of its cost of certain stocks it held to subscription rights issued on said stocks, which said subscription rights were sold by the petitioner during the years of 1958 and 1959?

C. Whether petitioner may assign a proportional share of its cost of certain stocks it held to fractional shares of

stock received as a stock dividend on said stocks, which said fractional shares were sold by petitioner during the taxable years of 1958 and 1959?

7. Should the Court conclude that petitioner is not liable to a tax on earnings, profits or surplus, other than paid-in surplus, earned and accumulated prior to January 1, 1939, and distributed to it in 1958, petitioner would be entitled to a refund computed as follows:

PRE 1939 SURPLUS NOT SUBJECT TO TAX

1958	\$24,987.00 (overpayment)
1959	3,418.22 (underpayment)
1960	4,043.92 (underpayment)

TOTAL \$17,524.68 (overpayment)

8. Should the Court conclude that petitioner is liable to a tax on earnings, profits or surplus, other than paid-in surplus, earned and accumulated prior to January 1, 1939, and distributed to it in 1958, petitioner would owe respondent additional tax computed as follows:

PRE 1939 SURPLUS SUBJECT TO TAX

1958	\$ 966.52 (underpayment)
1959	259.44 (overpayment)
1960	1,550.60 (underpayment)

TOTAL \$ 2,257.68 (underpayment)

9. Should the Court conclude that petitioner may assign a proportional share of its cost of certain stocks it held to subscription rights and fractional shares of stock sold by petitioner during the years of 1958 and 1959, petitioner would be entitled to a refund computed as follows:

PRE 1939 SURPLUS NOT SUBJECT TO TAX

1958	\$ 9.51 (overpayment)
195976 (overpayment)

TOTAL \$10.27 (overpayment)

10. Should the Court conclude that petitioner may not assign a proportional share of its costs of certain stocks it held to subscription rights and fractional shares of stock sold by petitioner during the year of 1958 and 1959, petitioner would owe additional tax to respondent computed as follows:

PRE 1939 SURPLUS SUBJECT TO TAX

1958	\$13.33 (underpayment)
1959	1.90 (underpayment)

TOTAL \$15.28 (underpayment)

11. Should the Court conclude that petitioner is liable to a tax on earnings, profits or surplus, other than paid-in surplus, earned and accumulated prior to January 1, 1939, and distributed to it in 1958, but that petitioner may assign a proportional share of its cost of certain stocks it held to subscription rights and fractional shares of stock sold during the years of 1958 and 1959, petitioner would be entitled to creditors computed as follows against the additional taxes due respondent as set forth in paragraph 8 herein-above:

PRE 1939 SURPLUS SUBJECT TO TAX

1958	\$13.33 (overpayment)
1959	1.90 (overpayment)

TOTAL \$15.28 (overpayment)

12. Petitioner and respondent agree that upon the filing by the Court of its findings of fact and opinion in this case, they will prepare and file with the Court, in accordance with the Court's determinations and pursuant to Rule 30 of the Rules of Procedure before the District of Columbia Tax Court, a computation reflecting the proper amount of interest due petitioner as a refund or a computation reflecting the proper amount of interest due from petitioner to respondent on the additional tax it owes, as the case may be.

13. To the extent that the findings of fact and opinion of the Court show, for the years of 1958, 1959 and 1960, that petitioner's liability to respondent for taxes and interest thereon was, under the District of Columbia Income and Franchise Tax Act of 1947, as amended, greater than the amounts of such taxes and interest assessed against and paid by petitioner, petitioner agrees that such assessments may be increased by the District of Columbia Tax Court in this proceeding.

14. Petitioner and respondent agree that the following documents may be received in evidence as a part of the record in this case:

A. Exhibits A, B, C, D and E attached to and made a part of petitioner's petition herein.

B. Exhibits A and B of Statement of Liquidating Dividends paid in 1958 and 1959 in complete liquidation of the Stockwood Investment Company, Incorporated, attached hereto and made a part hereof.

Respectfully submitted,

By _____
LARSON AND TOLLEY
Attorneys for Petitioner

CHARLES T. DUNCAN
Corporation Counsel, D. C.

HENRY E. WIXON
Attorneys for Respondent



STOCKWOOD INVESTMENT COMPANY, INCORPORATEDEXHIBIT BSTATEMENT OF NET WORTH, AND LIQUIDATING DIVIDENDS PAIDCAPITAL STOCK

\$1,750,000.00

RETAINED EARNINGS:

Balance, December 31, 1957 \$2,440,427.70

Add: Net Profit for the period January 1, 1958
to June 28, 1959, per Exhibit C 110,181.54

\$2,550,609.24

Less: Cash dividend paid \$105,875.00

Loss on liquidation of E. Z.

Chemical Co., Inc.

593,187.19 699,062.19RETAINED EARNINGS, JUNE 28, 19591,851,547.05TOTAL NET WORTH TO BE DISTRIBUTED IN LIQUIDATION\$3,601,547.05FIRST LIQUIDATING DIVIDEND PAID JULY 15, 1958:70,000 shares of Peoples Drug Stores
common stock, at cost

\$1,399,222.04

SECOND LIQUIDATING DIVIDEND PAID JULY 18, 1958:Equity in real estate, Schedule 1
Stocks, bonds and accounts receivable,
Schedule 2
Cash

\$1,534,192.87

511,138.10111,292.23

2,156,623.20

FINAL LIQUIDATING DIVIDEND, PAID JUNE 28, 1959:

Cash

45,701.81TOTAL DISTRIBUTION IN LIQUIDATION\$3,601,547.05

EXHIBIT A

STOCKWOOD INVESTMENT COMPANY, INCORPORATED
DISTRIBUTIONS TO STOCKHOLDERS IN LIQUIDATION

	Number of shares of stock	Total Liquidating Distribution	Source of Distribution 1958			1959 Retained Earnings after 12/31/58
			Capital Stock	Retained Earnings Prior to 1/1/59	Retained Earnings after 12/31/58	
Henry Foote Gibbs, Jr. #2 Trust	7,345	\$1,511,620.75	\$ 734,500.00	\$ 520,403.29	\$237,535.76	\$ 19,181.70
Angela Gloria Gibbs #2 Trust	7,345	1,511,620.75	734,500.00	520,403.29	237,535.76	19,181.70
Henry F. Gibbs #1 Trust	100	20,580.27	10,000.00	7,085.14	3,233.98	261.15
Henry F. Gibbs #2 Trust	650	133,771.75	65,000.00	46,053.39	21,020.86	1,697.50
St. Joseph's Home and School	97	19,962.86	9,700.00	6,872.58	3,136.96	253.32
Childrens Hospital of the District of Columbia	492	101,254.92	49,200.00	34,858.87	15,911.18	1,284.87
St. Vincent's Home and School	97	19,962.86	9,700.00	6,872.58	3,136.96	253.32
James Lawrence Kernan Hospital and Industrial School of Maryland for Crippled Children, Inc.	97	19,962.86	9,700.00	6,872.58	3,136.96	253.32
Masonic and Eastern Star Home of the District of Columbia	492	101,254.92	49,200.00	34,858.87	15,911.18	1,284.87
Florence Crittenton Home	196	40,337.33	19,600.00	13,886.87	6,338.59	511.87
Shriners' Hospital for Crippled Children	492	101,254.92	49,200.00	34,858.87	15,911.18	1,284.87
Episcopal Home for Children	97	19,962.86	9,700.00	6,872.58	3,136.96	253.32
<u>TOTALS</u>	17,900	\$3,601,547.05	\$1,750,000.00	\$1,239,898.91	\$565,946.33	\$ 45,701.81

[Filed December 8, 1964]

Petition

The above-named petitioner appeals from an assessment of taxes against it and avers as follows:

1. Petitioner is a corporation duly organized and doing business under the laws in force in the District of Columbia, and having its office and principal place of business at the address indicated in the caption of this case, where it is engaged in trust and banking business in the said District, and files this petition as surviving Trustee, under Item FIFTH of the Last Will and Testament of Malcolm G. Gibbs, deceased, for the benefit of Henry Foote Gibbs, Jr.

2. The taxes in controversy are fiduciary income taxes for the taxable years 1958, 1959 and 1960 in the total amount of Forty-three Thousand, Six Hundred Sixty-one Dollars and Seventy-one Cents (\$43,661.71), plus interest in the amount of Thirteen Thousand, Thirty Dollars and Forty-nine Cents (\$13,030.49).

3. Copies of the notices of assessment attached hereto and made a part hereof as Exhibits A, B and C, are dated September 11, 1964. The taxes were paid by petitioner on September 15, 1964, as evidenced by the stamp appearing on said Exhibits A, B and C and by the receipt on petitioner's letter of transmittal, a copy of which is attached hereto and made a part hereof as Exhibit D. Said payments were made as a result of deficiencies assessed by the respondent for the taxable years of 1958, 1959 and 1960. A copy of respondent's deficiency notice, together with accompanying schedules, is attached hereto and made a part hereof as Exhibit E.

4. The deficiency assessment is based upon the following errors:

A. Respondent erroneously determined that a portion of the liquidating dividend received by petitioner from the

Stockwood Investment Company, Incorporated, during the taxable year 1958, in the amount of \$520,403.29, and which was charged by the said Stockwood Investment Company against surplus, earned and accumulated prior to January 1, 1939, was taxable as an ordinary dividend. This determination constitutes a retroactive application of the provisions of Section 4 (M) of Title I of the District of Columbia Income and Franchise Tax Act of 1947 (Section 47-1551 c (M), D. C. Code, 1961 edition) and petitioner contends that said construction and application of the Act are unconstitutional and therefore void. The amount of the deficiency assessment for the taxable year 1956, which is based upon this erroneous determination, is \$26,020.16.

B. Respondent erroneously determined that petitioner in determining gain from the sale of real estate it had received during the liquidation of said Stockwood Investment Company and sold during the taxable years 1958, 1959 and 1960 should base the cost of said real estate on its "book value" rather than its "market value" at the time it was distributed to petitioner. The amount of the deficiency assessment for the taxable year 1958, which is based upon this erroneous determination, is \$3,334.88. The amount involved for the taxable year of 1959 is \$5,463.70, and the amount involved for the taxable year of 1960 is \$5,017.29.

C. Respondent erroneously determined that a share of the cost of the stocks could not be assigned by petitioner to the rights on said stocks issued and sold during the taxable years of 1958 and 1959, and that a share of the cost of the stocks could not be assigned by petitioner to fractional shares of stock received as stock dividends and sold during the taxable years of 1958 and 1959, in determining the gain from said sales and that the value of shares of stock received by petitioner from the liquidation of said Stockwood Investment Company and sold during the year of 1959 was the "book value" of said stock instead of the "market value" at the time it was distributed to petitioner. The

amount of the deficiency assessment for the taxable year 1958, which is based upon these erroneous determinations, is \$23.83. The amount involved for the year of 1959 is \$3,411.56.

D. Respondent erroneously determined that depreciation retained by petitioner in the years of 1958, 1959 and 1960, in accordance with the provisions of the will of the said Malcolm G. Gibbs, based upon "market value" at the time the real estate was distributed to petitioner by the said Stockwood Investment Company, was excessive in that it should have been based upon "book value". The amount of the deficiency assessments for the taxable year 1958, which is based upon this erroneous determination, is \$87.96. The amount involved for the year of 1959 is \$188.37, and the amount involved for the year of 1960 is \$113.96.

5. The facts upon which petitioner relies as the basis of this case are as follows:

A. A substantial portion of the liquidating dividend (\$520,403.29) received by petitioner from the Stockwood Investment Company in the year 1958 was charged against surplus earned and accumulated by said Company prior to January 1, 1939. The Court has judicially determined that the original Income and Franchise Tax Act of the District of Columbia, which became effective on January 1, 1939, did not tax distributions made by a corporation from its earnings, profits and surplus, if the earnings, profits and surplus of the corporation were earned and accumulated prior to January 1, 1939. On July 16, 1947, said Income and Franchise Act was amended by Congress by providing that distributions made by a corporation from its earnings, profits and surplus, *whenever earned*, were taxable to the recipient. Petitioner takes the position that said amendment applies only to dividends paid from earnings, profits and surplus of the corporation which were earned and accumulated after January 1, 1939. To construe said amend-

ment otherwise would constitute a retroactive application of the Act and would be unconstitutional.

B. When Stockwood Investment Company was liquidated, an undivided interest in a number of parcels of real estate were distributed to petitioner. During the taxable years of 1958, 1959 and 1960, some of said parcels of property were sold. Petitioner, in determining its cost for tax purposes in each sale, used the "market value" of its interest at the time it was distributed. Respondent, on the other hand, takes the position that petitioner's cost of its interest in each sale, should be based upon the "book value" of said real estate as reflected on the books of Stockwood Investment Company at the time the properties were distributed to petitioner.

C. Petitioner received stock dividends on stock it held as Trustee. To the stock received and sold, petitioner assigned a portion of the cost of the original stock in determining gain or loss. Respondent takes the position that petitioner cannot assign any cost to the stock sold, and that the proceeds from said sale should be treated, for tax purposes, as fully taxable.

D. Petitioner received certain rights on stock it held as Trustee. To the rights received and sold, petitioner assigned a portion of the cost of the stock to said rights in determining the gain or loss. Respondent takes the position that petitioner cannot assign any cost to the stock rights sold, and the proceeds from said sale should be treated, for tax purposes, as fully taxable.

E. Petitioner transferred certain amounts from its income account to its capital account as depreciation on real properties during the years of 1958, 1959 and 1960, in accordance with the provisions of the will of Malcolm G. Gibbs. The amount was based upon the "market value" of the real property distributed to it by the Stockwood Investment Company at the time of distribution. Respondent

contends that the excess of any depreciation reserve transferred to capital over what it considered to be the proper amount (based on "book value" instead of "market value") should be taxable as income to petitioner as Trustee.

F. Prior to the assessment of the tax deficiencies set forth hereinabove, representatives of petitioner and respondent had numerous conferences regarding the taxes in controversy. Although the parties were unable to agree as to the application of the law involved, the parties were in agreement as to the figures used to compute the tax deficiencies, and the schedules attached to Exhibit E hereto are the combined work product of both petitioner and respondent. Petitioner believes that there are no issues of fact to be resolved in this case and that the Court will have to rule on questions of law only. For these reasons, petitioner deems it unnecessary to set forth all of the involved figures and computations which were used to arrive at the deficiency assessments set forth hereinabove.

WHEREFORE the petitioner prays that this Court may hear the case and grant the following relief:

1. That the Court cancel the deficiency assessments set forth hereinabove and direct respondent to refund the amount of such deficiencies to petitioner with interest thereon, as provided by law.

2. For such other relief as the Court may deem proper.

AMERICAN SECURITY AND TRUST COMPANY

By: /s/ JOSEPH L. WHYTE

Vice President and Trust Officer, Surviving Trustee under will of MALCOLM G. GIBBS, for the benefit of HENRY FOOTE GIBBS, JR. Petitioner



GOVERNMENT OF THE DISTRICT OF COLUMBIA
FINANCE OFFICE • Revenue Division

INCOME AND FRANCHISE TAX

T Y P E A B	1-Individual Income 2-Declaration Payment 3-Corporation 4-Unincorporated Business 5-Partnership 6-Employer Withholding	ACCOUNT NUMBER 1521009	REF. 2	TAX YEAR 1960	DATE 9/15/64	
NAME AND ADDRESS Angela Gloria Gibbs c/o Trust 03564 American Security & Trust Co. 15th. St. & Penna. Ave., N.W., Washington, D. C. 20003-04		TOTAL TAX DOLLARS 29,466	CTS. 83	CREDIT DOLLARS 9,576	CTS. 72	PAYMENT DUE DOLLARS 39,043
				INTEREST TO 9/15/64		CTS. 55

Interest on payment due at the rate of 1/2 of 1% per month or portion thereof must be added if not paid on or before the interest date shown on this bill. Late filing penalty is computed at 5% per month or portion thereof (maximum 25%), except type tax E which is a flat 25%.

Make check payable to D.C. TREASURER. Send check or money order to FINANCE OFFICE, REVENUE DIVISION, Municipal Center, Washington, D.C.

PP-36 (7/60) Your cancelled check is your receipt.

SEP-15-64 392 2150A 39043.55

PAID-- D.C. Treasurer

EXHIBIT A

KEEP THIS COPY

GOVERNMENT OF THE DISTRICT OF COLUMBIA
FINANCE OFFICE • Revenue Division

INCOME AND FRANCHISE TAX

T Y P E A B	1-Individual Income 2-Declaration Payment 3-Corporation 4-Unincorporated Business 5-Partnership 6-Employer Withholding	ACCOUNT NUMBER 3700000	REF. 2	TAX YEAR 1960	DATE 9/15/64	
NAME AND ADDRESS Angela Gloria Gibbs c/o Trust 03564 American Security & Trust Co. 15th. & Penna. Ave., N.W., Washington, D. C. 20003-04		TOTAL TAX DOLLARS 10,045	CTS. 20	CREDIT DOLLARS 2,661	CTS. 98	PAYMENT DUE DOLLARS 12,707
				INTEREST TO 9/15/64		CTS. 18

Interest on payment due at the rate of 1/2 of 1% per month or portion thereof must be added if not paid on or before the interest date shown on this bill. Late filing penalty is computed at 5% per month or portion thereof (maximum 25%), except type tax E which is a flat 25%.

Make check payable to D.C. TREASURER. Send check or money order to FINANCE OFFICE, REVENUE DIVISION, Municipal Center, Washington, D.C.

PP-36 (7/60) Your cancelled check is your receipt.

SEP-15-64 393 2150A 12707.18

PAID-- D.C. Treasurer

EXHIBIT B

KEEP THIS COPY

GOVERNMENT OF THE DISTRICT OF COLUMBIA
FINANCE OFFICE • Revenue Division

INCOME AND FRANCHISE TAX

T Y P E A B	1-Individual Income 2-Declaration Payment 3-Corporation 4-Unincorporated Business 5-Partnership 6-Employer Withholding	ACCOUNT NUMBER 2170000	REF. 2	TAX YEAR 1960	DATE 9/15/64	
NAME AND ADDRESS Angela Gloria Gibbs c/o Trust 03564 American Security & Trust Co. 15th. & Penna. Ave., N.W., Washington, D. C. 20003-04		TOTAL TAX DOLLARS 5,231	CTS. 25	CREDIT DOLLARS 3,051	CTS. 91	PAYMENT DUE DOLLARS 6,183
				INTEREST TO 9/25/64		CTS. 16

Interest on payment due at the rate of 1/2 of 1% per month or portion thereof must be added if not paid on or before the interest date shown on this bill. Late filing penalty is computed at 5% per month or portion thereof (maximum 25%), except type tax E which is a flat 25%.

Make check payable to D.C. TREASURER. Send check or money order to FINANCE OFFICE, REVENUE DIVISION, Municipal Center, Washington, D.C.

PP-36 (7/60) Your cancelled check is your receipt.

SEP-15-64 394 2150A 6183.16

PAID-- D.C. Treasurer

EXHIBIT C

KEEP THIS COPY



EXHIBIT D

COPY

AMERICAN SECURITY AND TRUST COMPANY
WASHINGTON, D. C.

September 15, 1964

Re: Henry Foote Gibbs, Jr. #2 Tr #3573
Your Reference: # 1827008 (58)
2726701 (59)
3470302 (60) (WRE)

D. C. Treasurer
Finance Office, Revenue Division
Municipal Center
Washington, D. C. 20001

Dear Sir:

Enclosed herewith please find check of this Company in the amount of \$57,933.89 in full payment of the taxes and interest assessed against the above-named Trust for the taxable years of 1958, 1959 and 1960.

Said taxes and interest for said years are being paid by this Company as Trustee *under protest*.

Very truly yours,

AMERICAN SECURITY AND TRUST COMPANY

By /s/ JOSEPH L. WHYTE
Vice President and Trust Officer
Surviving Trustee U/W of Malcolm G. Gibbs for Henry Foote Gibbs, Jr.

Enclosure

EXHIBIT E

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
DEPARTMENT OF GENERAL ADMINISTRATION**

**Finance Office:
Revenue Division**

**Certified Mail
Return Receipt Requested**

**Reply to:
Income and Franchise Tax Section
Room 2034, Municipal Center
300 Indiana Avenue, N. W.
Washington 1, D. C.**

August 31, 1964

**Henry Foote Gibbs, Jr. #2 Trust #3573
c/o American Security and Trust Company
15th Street and Pennsylvania Ave., N. W.
Washington, D. C.**

**Re: # 1827008 (58),
2726701 (59) and
3470302 (60) (WRE)**

Gentlemen:

The examination by this office of your Fiduciary Income Tax return(s) for the year(s) ended December 31, 1958, 1959 and 1960, indicates that the adjustment of your tax liability, as shown in the accompanying Report(s) of D. C. Individual Income Tax Audit Changes, is warranted.

IF YOU AGREE to the adjustment(s) as shown in the report(s), the enclosed form of waiver should be executed and forwarded to this office promptly. Action will then be taken as indicated on line 13 or 14 of the report(s), whichever is applicable.

IF YOU DO NOT AGREE to the adjustment(s), you may file a protest with this office, within thirty (30) days from

the date of this letter, stating the grounds for your exceptions. Careful consideration will be given to such protest and, if you so request, an opportunity for a hearing in this office will be granted to you prior to final determination.

Should you fail to file either the enclosed waiver form or a written protest with this office within the thirty (30) day period, final determination of your tax liability will be made in accordance with the enclosed report(s).

Your very truly,

BEN A. BARSKY

Ben A. Barsky

Supervisory Tax Auditor

Income and Franchise Tax

Section

Enclosures:

Waiver Form

Statement(s)

FR-181 (Rev. 8/61)

GOVERNMENT OF THE DISTRICT OF COLUMBIA

FINANCE OFFICE

Revenue Division

* * * *

WAIVER OF HEARING AND REQUEST FOR IMMEDIATE
ASSESSMENT OF DEFICIENCY IN TAX

The hearing provided for in Section 31 of the District of Columbia Income Tax Act of 1939 and/or Title XII, Section 5 of the District of Columbia Income and Franchise Tax Act of 1947 is hereby waived and consent is given to the assessment of the following deficiency or deficiencies in tax:

Year Ended	Deficiency in Tax	Total
December 31, 1958	\$29,466.83	\$29,466.83
December 31, 1959	10,045.20	10,045.20
December 31, 1960	5,131.25	5,131.25

The execution and filing of this waiver with the Finance Officer of the District of Columbia will expedite the adjustment of your tax liability as indicated in the enclosed statement(s) or report(s). It is not, however, a final closing agreement under Section 35 of the District of Columbia Income Tax Act of 1939, or under Title XII, Section 12 of the District of Columbia Income and Franchise Tax Act of 1947, and does not, therefore, preclude the assertion of a further deficiency in the manner provided by law should it subsequently be determined that additional tax is due, nor does it extend the statutory period of limitation for refund, assessment or collection of the tax.

If the waiver is executed with respect to a year for which a JOINT RETURN OF A HUSBAND AND WIFE was filed, it must be signed by both spouses, except that one spouse may sign as the agent for the other.

Signature(s) of Taxpayer(s)

HENRY FOOTE GIBBS, JR. # 2 Trust # 3573

Address of Taxpayer

ByDate.....

FR-182 (8-61)

Henry Foote Gibbs, Jr. #2 Trust #3573 c/o American Security and Trust Company, 15th Street and Pennsylvania Avenue, N.W., Washington, D.C.

FIDUCIARY INCOME TAX

Calendar year	(1827008) 1958	(2726701) 1959	(3470302) 1960
Net taxable income reported	\$238,254.15	\$ 57,095.08	\$ 50,168.73
Additional dividend	520,403.30	19,181.70	
Depreciation disallowed	1,759.21	3,767.35	2,279.29
Gain on sale of non-capital assets	67,174.13	177,954.82	100,345.78
Revised net taxable income	<u>\$827,590.79</u>	<u>\$257,998.95</u>	<u>\$152,793.80</u>
Revised tax	\$ 41,004.54	\$ 12,524.95	\$ 7,264.69
Less: tax previously assessed	11,537.71	2,479.75	2,133.44
Deficiency	<u>\$ 29,466.83</u>	<u>\$ 10,045.20</u>	<u>\$ 5,131.25</u>

¹ Distributions received in liquidation of Stockwood Investment Co.		
Trusts share of earned surplus		\$1,492,439.06
Less: trusts share of capital stock		734,500.00
Dividend		\$ 757,939.06
Less: amount previously reported		237,535.76
Additional dividend		<u>\$ 520,403.30</u>

2	1958	1959	1960
Depreciation claimed on return	\$5,179.82	\$ 8,667.25	\$ 5,437.97
Depreciation allowed ($\frac{1}{2}$ of Schedule A)	3,420.61	4,899.90	3,158.68
Depreciation disallowed	<u>\$1,759.21</u>	<u>\$ 3,767.36</u>	<u>\$ 2,279.29</u>
³ Gain on sale of real property*	\$67,447.15	\$144,427.10	\$150,614.49
Gain on sale of other property**	545.37	90,722.80	
Total	<u>\$67,992.52</u>	<u>\$235,149.90</u>	<u>\$150,614.49</u>
Less: reported	818.39	57,195.08	50,268.71
Additional gain	<u>\$67,174.13</u>	<u>\$177,954.82</u>	<u>\$100,345.78</u>

* From Schedule B.

** From Schedule C.

BRIEF FOR RESPONDENT

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 21,811

AMERICAN SECURITY AND TRUST COMPANY, TRUSTEE
U/W OF MALCOLM G. GIBBS f/b/o ANGELA GLORIA
GIBBS,

Petitioner,

v.

DISTRICT OF COLUMBIA,

Respondent.

No. 21,812

AMERICAN SECURITY AND TRUST COMPANY, TRUSTEE
U/W OF MALCOLM G. GIBBS f/b/o HENRY FOOTE GIBBS, JR.,

Petitioner,

v.

DISTRICT OF COLUMBIA,

Respondent.

ON PETITION FOR REVIEW OF DECISIONS OF
THE DISTRICT OF COLUMBIA TAX COURT

United States Court of Appeals
for the District of Columbia Circuit

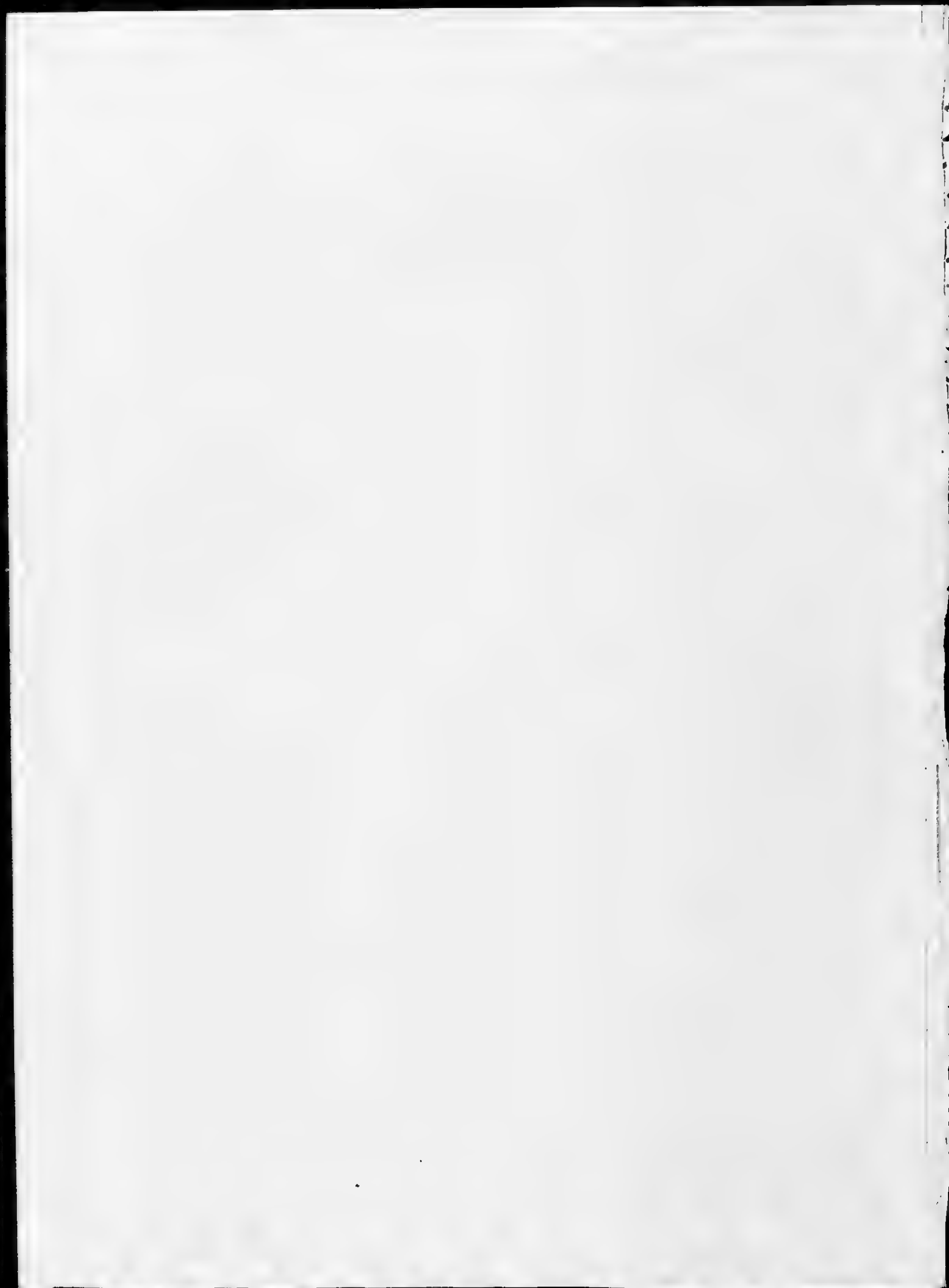
FILED JUN 26 1968

Nathan J. Paulson
CLERK

CHARLES T. DUNCAN *64*
Corporation Counsel, D.C.

HUBERT B. PAIR *01*
Principal Assistant Corporation
Counsel, D.C.

HENRY E. WIXON *OK*
Assistant Corporation Counsel, D.C.
Attorneys for Respondent
District Building
Washington, D.C. 20004



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* Cases chiefly relied upon are marked by asterisks.



QUESTION PRESENTED

In the view of respondent the brief for petitioner correctly sets forth the question presented.



IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

AMERICAN SECURITY AND TRUST COMPANY, TRUSTEE)
U/W OF MALCOLM G. GIBBS f/b/o ANGELA GLORIA)
GIBBS,)

Petitioner,)

v.)

No. 21,811

DISTRICT OF COLUMBIA,)

Respondent.)

AMERICAN SECURITY AND TRUST COMPANY, TRUSTEE)
U/W OF MALCOLM G. GIBBS f/b/o HENRY FOOTE)
GIBBS, JR.,)

Petitioner,)

v.)

No. 21,812

DISTRICT OF COLUMBIA,)

Respondent.)

BRIEF FOR RESPONDENT

COUNTER-STATEMENT OF THE CASE

Respondent accepts petitioner's statement of the
case.

SUMMARY OF ARGUMENT

Decisions of the Board of Tax Appeals under the
District's 1939 income tax act holding that distributions of

surplus, earned by corporations prior to January 1, 1939, were not taxable as dividends, based as they were upon Lynch v. Hornby, 247 U.S. 339 (1918), were incorrectly decided. Even if those decisions were correct, they were concerned only with the 1939 Act, and have no relevance to distributions of surplus made by corporations following enactment of the District of Columbia Income and Franchise Tax Act of 1947. That act made taxable distributions by a corporation out of its earnings, profits, or surplus, whenever earned, contrary to the 1939 statute which did not contain in its definition of a dividend any reference to time. The addition of the words "whenever earned" clearly indicates the intention of the Congress to tax any distribution of corporate earnings made on or after the first day of January, 1947, irrespective of the time when the earnings were obtained.

Federal and State court decisions have uniformly held that the Congress and the States may subject to tax dividends paid to corporate shareholders. Arguments that such distributions, when made out of earnings of the corporation obtained prior to the date of enactment of the particular taxing act, are distributions of capital have uniformly been rejected.

No issue of retroactivity is, in fact, involved in this case, nor is the District's statute impaired by reference to any provision of the Constitution. Federal and State taxing acts have consistently contained language taxing dividends in the same basic manner as does the District's statute. The District of Columbia Tax Court was clearly correct in affirming the assessments of tax against petitioner.

ARGUMENT

The question here presented is whether, under the District of Columbia Income and Franchise Tax Act of 1947, as amended, distributions by Stockwood Investment Company, Inc. made to petitioner out of its earnings, profits, or surplus accumulated prior to January 1, 1939 are taxable to petitioner as a dividend. In support of its contention to the contrary petitioner cites three decisions of the then Board of Tax Appeals of the District of Columbia: Cooper v. District of Columbia, D.C. B.T.A. Opinion No. 617; Himmelfarb v. District of Columbia, D.C. B.T.A. Opinion No. 628; and Harrison v. District of Columbia, D.C. B.T.A. Opinion No. 644, vacated by 644-A,¹ all involving the District's 1939

1. Petitioner's brief pp. 4-5.

Income Tax Act and all to the effect that the taxpayers in those cases were not subject to tax on the distribution to them of earnings or profits of a corporation in which they held stock to the extent that the distribution was out of surplus accumulated by the corporation prior to January 1, 1939. In Harrison, Judge Koenigsberger relied upon Lynch v. Hornby, 247 U.S. 339 (1918), a case arising under the Federal Income Tax Act of 1913, involving the liability of Hornby for a tax on a dividend paid to him by a corporation in which he was a stockholder, the source of which was the sale by the corporation of property which it owned or in which it had an interest on March 1, 1913. The 1913 Income Tax Act assessed against persons liable therefor a tax " * * * upon the entire net income arising or accruing from all sources in the preceding calendar year * * *."

(Emphasis added.) Distinguishing the case from Lynch v. Turrish, 247 U.S. 221 (1918) on the ground that Turrish involved the liquidation of a corporation, whereas, in Hornby, the distribution was made by a going concern, the Supreme Court held Hornby liable for tax. In Turrish, the Court had held that when the corporation in which Turrish was a stockholder was liquidated, and Turrish received

from the surrender of his stock in dissolution twice its par value, he was not liable for the excess for the reason that, upon the sale of the corporation's assets to another company immediately prior to dissolution, Turrish received only the amount which represented the intrinsic value of his stock in the corporation. In the course of its opinion the Court said:

" * * * If increase in value of the lands was income, it had its particular time and such time must have been within the time of the law to be subject to the law, that is, it must have been after March 1, 1913. But, according to the fact admitted, there was no increase after that date and therefore no increase subject to the law. There was continuity of value, not gain or increase.
* * * " 247 U.S. 229.

Petitioner contends that it is not clear that by the inclusion of the words "whenever earned" in the definition of the word "dividend" in the 1947 Act, Congress intended that dividends out of earnings, profits or surplus obtained prior to 1939 should be taxed. Certainly, the words "whenever earned" must be given their ordinary meaning; otherwise, they are of no significance whatever. Indeed, the contention made by petitioner concerning pre-1939 earnings could be made as to pre-1947 earnings, for the 1947 Act repealed

the 1939 Act. The emphasis which the taxpayer places upon the year 1939 does not seem to respondent to have any relevance to the taxability of a dividend under the 1947 Act.

Pursuant to Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429 (1895), prior to the adoption of the Sixteenth Amendment to the Constitution the Congress was without authority (at least it's authority was decidedly unclear) to impose a tax upon income from personal property without apportioning the tax among the States according to population. But the considerations which motivated the Congress to exclude from federal tax pre-1913 income were not present when the District's 1939 income tax act was adopted; there was no constitutional impediment in respect of the District of Columbia, such as existed in connection with the imposition of a National income tax. Thus, it would appear that the decisions of the Board of Tax Appeals in Cooper, Himmelfarb and Harrison, supra, are of doubtful validity, particularly in their reliance upon Lynch v. Hornby, supra.

It was established in Lynch v. Hornby, supra, and in Welch v. Henry, 305 U.S. 134 (1938), that dividends received by a taxpayer from a corporation in which he holds stock are taxable. As was said in Welch:

" * * * It cannot be doubted that the receipt of dividends from a corporation is an event which may constitutionally be taxed either with or without deductions, (citations omitted) even though the corporate income which is their source has also been taxed. * * * " 305 U.S. 143.

And in Welch, the Court rejected an argument that the Wisconsin tax there involved was unlawful because it was retroactive.

Although, in holding that the receipt of pre-January 1, 1939 surplus of a liquidating corporation was not taxable to the recipient, Judge Koenigsberger apparently was of the view that Lynch v. Turrish was controlling because he viewed that case as establishing the premise that the income derived by a corporation prior to the enactment for the District of the 1939 Income Tax Act represented capital of the corporation, Lynch v. Hornby does not appear to support that premise. As was said in Hornby:

"In the more recent Income Tax Acts, provisions have been inserted for the purpose of excluding from the effect of the tax any dividends declared out of earnings or profits that accrued prior to March 1, 1913. * * * " 2

-
2. And in connection with the reliance of petitioner upon Southern Pacific Company v. Lowe, 247 U.S. 330 (1918) (Pet.'s Br. p. 12), see Peabody v. Eisner, 247 U.S. 347, 349 (1918) in which the Court discusses the reasons for its decision in Southern Pacific Company.

Said the court, this change was " * * * a concession to the equity of stockholders granted in the 1916 Act * * *." Commenting upon Turrish, the Supreme Court of Oregon, in Kelly v. Galloway, 156 Ore. 301, 66 P.2d 272, 275 (1937), said:

" * * * In holding that Turrish's receipts from this transaction were non-taxable, the court regarded the transaction, not as the receipt of a dividend by Turrish, but as a sale of his stock. * * * "
(Emphasis supplied.)

In U.S. v. Safety Car Heating Company, 297 U.S. 88 (1936), the Court, speaking of the Federal Taxing Acts, said:

" * * * Thus, Congress has now provided (see, e.g., Revenue Act of 1916, c. 463, § 2 (a), 39 Stat. 756, 757; Revenue Act of 1921, c. 135, § 201, 42 Stat. 224, 228; Revenue Act of 1926, c. 27, § 201, 44 Stat. 9, 10) that dividends may be distributed exempt from the tax to the extent that they are made out of earnings or profits accumulated before March 1, 1913. The exemption is 'a concession to the equity of stockholders' (Lynch v. Hornby, 247 U.S. 339, 346; Helvering v. Canfield, 291 U.S. 163, 167), and had no existence under the pioneer statute, the Act of 1913, a dividend, irrespective of its source, being then taxable altogether. Lynch v. Hornby, supra. * * * "

And of considerable importance is Helvering v. Canfield, 291 U.S. 163 (1934), where the following appears:

"The argument that the surplus of March 1, 1913, constituted capital is unavailing. We are not here concerned with capital in the sense of fixed or paid-in capital, which is not to be impaired, or with the restoration of such capital where there has been impairment. No case of impairment of capital is presented. We are dealing with a distribution of accumulated profits. Nor is it important that the accumulated profits as they stood on March 1, 1913, constituted capital of the company as distinguished from the gains or income which the company subsequently realized. When a corporation continued in business after March 1, 1913, the dividends it later declared and paid to its stockholders, whether out of current earnings or from profits accumulated prior to that date, constituted income to the stockholders, and not capital, and were taxable as income if the Congress saw fit to impose the tax. Lynch v. Hornby, 247 U.S. 339, 62 L. ed. 1149, 38 S. Ct. 543. The provision of the Act of Congress under consideration was a 'concession to the equity of stockholders' with respect to receipts as to which they had no constitutional immunity. There is no question here of the receipt of 'capital.' " (Emphasis supplied; Footnotes omitted.)

From a reading of the cases following Lynch v. Turrish, it would appear that that decision was based upon the particular facts there presented; not upon the absence of authority in the Congress to impose a tax upon the receipt by Turrish of earnings of the corporation in which he held stock and which earnings had been obtained prior to 1913. Certainly, it is clear in the instant case that if the

amounts received by petitioner from Stockwood Investment Company are taxable as a dividend, the fact that the earnings distributed were obtained prior to January 1, 1939 is immaterial. The Federal courts and numerous state courts have so held. See for State cases Follett v. Commissioner of Corporations and Taxation, 267 Mass. 115, 166 N.E. 575 (1929); Lapham v. Tax Commissioner, 244 Mass. 40, 138 N.E. 708 (1923); Tax Commissioner v. Putnam, 227 Mass. 522, 116 N.E. 904 (1917); Kelly v. Galloway, supra; Martin v. State Board of Assessment and Review, 225 Iowa 1319, 283 N.W. 418 (1939); West v. Wisconsin Tax Commission, 207 Wis. 557, 242 N.W. 165 (1932); Van Dyke v. City of Milwaukee, 159 Wis. 460, 146 N.W. 812 (1914).

Follett v. Commissioner of Corporations and Taxation, supra, is particularly applicable in that it involved the legality, under a Massachusetts taxing statute, of the imposition of a tax upon a liquidating dividend paid by a corporation out of its earnings accrued both prior and after the enactment of the Massachusetts Taxing Act. The entire dividend was held to be taxable, although the Taxing Act was enacted in 1916 and liquidation occurred in 1925. Although the case does not refer to the fact that the

Taxing Act was enacted in 1916, this fact can be ascertained by reference to Tax Commissioner v. Putnam, supra. See also the annotation to Follett in 65 A.L.R. at 148.

In its opinion (J.A. 10-11) the Tax Court quoted from Follett v. Commissioner, supra, in which reference is made to Tax Commissioner v. Putnam, supra, and Lanning v. Tax Commissioner, 247 Mass. 496, 142 N.E. 829 (1924). Although petitioner apparently does not consider Tax Commissioner v. Putnam, supra, of importance, one of the questions upon which the Court's decision was unanimous was whether a cash dividend declared and paid after the taxing statute took effect, out of profits earned before it was enacted, was taxable as income. As the Court in its opinion said:

" * * * The extra cash dividend was declared out of surplus earnings which had accumulated during 23 years previous to March 1, 1913. Although it was large and had been accumulating for a long time, it was not the less a cash dividend. It came to the shareholder as his individual property for the first time when declared and paid in 1916. It was not in substance or effect a distribution of capital.
* * * " 116 N.E. 912.

The reference by petitioner (Pet.'s Br. p. 10) to the absence in Putnam of a question of statutory interpretation of constitutionality is explained by this quotation from the Court's opinion:

" * * * Therefore no question either of statute interpretation or constitutionality is raised in the cases at bar as to an attempt to tax gains on the value of property, which have not been realized by sale and which would be known in common speech as mere paper profits, and nothing to that point is here decided." 116 N.E. 909.

The point in Lanning v. Tax Commissioner, supra, was that a stock dividend voted by the paying corporation before the year 1916, payable to and received by taxpayer in January of the year 1916, which was prior to the enactment of the income tax law on May 26, 1916, was held to be subject to tax. The statute provided that the tax was first to be levied in the year 1917 on all income received by the taxpayer during the preceding calendar year. The contention of retroactivity was thus rejected. So far as counsel for the District are aware it has never been suggested that Congress when it enacts a new federal income tax act may not subject to tax as a dividend distributed earnings of a corporation obtained prior to the time of the enactment. The status of District law can hardly be different.

Contrary to the argument on behalf of the taxpayers in this case retroactivity is not involved. The income of the distributing corporation is not being taxed; the tax is upon

a dividend received by a stockholder, since he is not entitled to the earnings of the corporation until they are made available to him in the form of a dividend, as defined by the District's statute. On the issue of retroactivity petitioner places major reliance upon People ex rel Beck v. Graves, 280 N.Y. 405, 21 N.E.2d 371 (1939) and Lacidem Realty Corp. v. Graves, 288 N.Y. 354, 43 N.E.2d 440 (1942). Both of these cases involved the imposition of a tax on income obtained in years prior to the time of enactment of the taxing laws. In People ex rel Beck, by a 1935 enactment, income received by the taxpayers in 1930, 1931, and 1933 was subjected to tax. In Lacidem Realty Corp. the tax was made retroactive from 1941 to 1937. In both cases income not previously subject to tax was retroactively taxed. The later case of Comptroller of Treasury v. Glen L. Martin Company, 216 Md. 235, 140 A.2d 288 (1958) cited by petitioner is of the same category as the New York cases for, as the Court of Appeals of Maryland said, that case involved an imposition by a 1957 taxing act of a tax on transactions completed long before its enactment, as long as ten years. Here, however, the taxable event was the receipt by the District taxpayers of dividends. The taxing statute had been in effect for some

years when the dividends were received. Clearly, cases relied upon to support the contention that the District's statute is retroactive are distinguishable upon the facts.

CONCLUSION

It is respectfully submitted that the decisions of the District of Columbia Tax Court affirming the assessments of tax against petitioner were correct and should be sustained.

CHARLES T. DUNCAN
Corporation Counsel, D.C.

HUBERT B. PAIR
Principal Assistant Corporation
Counsel, D.C.

HENRY E. WIXON
Assistant Corporation Counsel, D.C.

Attorneys for Respondent
District Building
Washington, D.C. 20004

